

Gariep Municipality

Audit Report

For the year ended 30 June 2013

**REPORT OF THE AUDITOR-GENERAL TO EASTERN CAPE PROVINCIAL
LEGISLATURE AND THE COUNCIL ON GARIEP LOCAL MUNICIPALITY
REPORT ON THE FINANCIAL STATEMENTS**

Introduction

1. I have audited the financial statements of the Gariep Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2013, the statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Generally Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No. 5 of 2012) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my adverse audit opinion.

Basis for adverse opinion

Investment property

6. The municipality recognised items that did not meet the definition of investment property as per GRAP 16 – Investment properties; resulting in an overstatement of investment property by R1 337 833 as disclosed in note 2 and an understatement in property, plant and equipment as disclosed in note 3 to the financial statements

Property, plant and equipment

7. Sufficient appropriate audit evidence was not available to support the adjusting journals to property, plant and equipment. Supporting documentation was either not submitted for audit purposes, or that which was submitted was incomplete. I was unable to confirm

the adjustment by alternative means. Consequently I was unable to determine whether any adjustments were necessary to property, plant and equipment of R348 837 450, as disclosed in note 3 to the financial statements.

8. The municipality incorrectly recognised items as additions to infrastructure assets and community assets which did not meet the definition of an asset acquired during the financial year as it related to items acquired in prior periods resulting in an overstatement of additions to infrastructure assets and community assets by R148 391 811 (2012: 10 388 768), as disclosed in note 3 and an understatement of accumulated surplus by the same amount. In addition infrastructure assets was understated by R11 062 377 and work in progress was overstated by the same amount, as a result of completed projects that were not capitalized.
9. The municipality recognised land and buildings that did not meet the definition of an asset as per GRAP 17 – Property, plant and equipment; resulting in land and buildings being overstated by R47 513 5058 and accumulated surplus being understated by the same amount. In addition the municipality has recognised land and buildings at incorrect amounts resulting in an overstatement of R4 045 503.

Payables from exchange transactions

10. The municipality did not have adequate systems in place to maintain records of accounts payable for goods and services received but not yet paid and reconciling items for accounts payable balances, which resulted in trade payables being understated by R9 373 363 and expenditure overstated by a similar amount. In addition, I was unable to obtain sufficient appropriate audit evidence for the amounts disclosed as trade payables in note 18 to the financial statements and I could not confirm the disclosure by alternative means. Consequently I was unable to determine whether any further adjustments to accounts payable stated at R107 374 401 in the financial statements were necessary.

Prior period errors

11. The municipality did not disclose prior period errors in accordance with GRAP 3 Accounting Policies, Changes in Accounting Estimates and Errors. As disclosed in note 37 to the financial statements, corresponding figures have been restated by R31 429 in order to address prior year misstatements. However, prior period adjustments amounting to R6 265 550 have been recorded in the statement of changes in net assets, resulting in a material difference of R6 234 121. In addition prior period errors amounting to R941 962 were not disclosed and an item amounting to R142 170 699 was incorrectly disclosed in the notes and statement of changes in net assets. Consequently, prior period errors as disclosed in note 37 of the financial statements are materially understated as well as the statement of net assets.

Provisions

12. The municipality incorrectly recognised bonus accrued for the financial year as a provision resulting in accruals being understated by R870 564 and provisions as disclosed in note 15 to the financial statements being overstated by R870 564.
13. In addition, I was unable to obtain sufficient appropriate audit evidence for the two landfill sites that were not assessed in the environmental rehabilitation provision and I was unable confirm to the amount by alternative means. Consequently I was unable to determine whether any further adjustments to provisions stated at R1 992 844 in the financial statements were necessary.

Income from agency services

14. The municipality did not recognise payments made by the district municipality on its behalf regarding water services. Consequently, Income from agency fees as disclosed in the statement of financial performance is understated by R2 389 074 and expenditure by a similar amount as a result of incomplete recording of payments.

Discontinued operations

15. The municipality did not have adequate systems in place to ensure that grants and subsidies are paid to water services indigent debtors who are entitled to free basic services and as a result discontinued operations expenditure is materially overstated by R13 017 352 as disclosed in note 12 to the financial statements.
16. Sufficient appropriate audit evidence could not be obtained to confirm the adjustment to the financial statements submitted for audit purposes since unaudited adjustment were processed by the municipality. We are unable to confirm the amounts by alternative means. Consequently discontinued operations as disclosed in note 12 to the financial statements is misstated by R4 251 454 (2012: R21 961 061).

Cash flow statement

17. The municipality did not prepare the cash flow statement in accordance with GRAP 2: cash flow statements in that amounts were incorrectly calculated and reflected . In addition, sufficient appropriate audit evidence was not available to confirm the valuation of the net cash flow movement of R2 228 416 (2012: R10 108 443) as a result of the misstatement of the statement of financial position and financial performance and an inability to confirm the amounts in the preceding line items on the cash flow statement which form the basis of the cash flow statement. I was unable to determine the full extent of the misstatement by alternative means. Consequently, I was unable to determine whether any adjustments to the cash flow statement were necessary.

Statement of comparison of budget and actual amounts

18. The municipality did not prepare the budget statement in accordance with GRAP 24: presentation of budget information statements in that no explanation of material differences were disclosed or that which was disclosed or that which was disclosed was insufficient. In addition, sufficient appropriate audit evidence was not available to confirm the movements between budget and actual figures. I was unable to determine the full extent of the misstatement by alternative means. Consequently, I was unable to determine whether any adjustments to the budget statement were necessary.

Commitments

19. Sufficient appropriate audit evidence could not be obtained to confirm the adjustment to the financial statements submitted for audit purposes since unaudited adjustment were processed by the municipality. We were unable to confirm the amounts by alternative means. Consequently commitments as disclosed in note 35 to the financial statements is misstated by R1 556 911.

Unauthorised expenditure

20. The municipality is required by section 125(2)(d)(i) of the MFMA to disclose unauthorised expenditure. The municipality did not disclose the expenditure amounts in excess of the approved budget per vote. Consequently, note 42 of the financial statement is overstated by R14 115 444.

Fruitless and wasteful expenditure

21. The municipality did not have adequate systems in place to identify and disclose all

fruitless and wasteful expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA. The fruitless and wasteful expenditure disclosed in note 43 to the financial statements is understated in respect of an amount of R515 785 incurred during the year that were identified during the audit process. The full extent of the understatement of fruitless and wasteful expenditure disclosed as R1 125 075(2012: R2 398 111) is R2 468 874, however the adjustment was not made in the financial statements. Consequently, fruitless and wasteful expenditure is materially understated.

Irregular expenditure

22. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA. The irregular expenditure disclosed in note 44 to the financial statements is understated in respect of an amount of R533 492 incurred during the year that were identified during the audit process. Due to the lack of systems, it was impracticable to determine the full extent of the understatement of irregular expenditure disclosed at R7 976 111(2012: R8 419 504). I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the irregular expenditure disclosure note.

Material losses

23. The municipality did not disclose material losses for water in the financial statements as required by section 125(2)(d)(i) of the MFMA. I have not determined the correct disclosure amounts for material losses for water as it was impracticable to do so.

Aggregation of immaterial uncorrected misstatements

24. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position and the statement of financial performance:
- Interest received as disclosed on the statement of financial performance is overstated by R965 422;
 - Employee costs as disclosed on the statement of financial performance is overstated by R646 699;
 - Consumer debtors as disclosed in note 10 to the financial statements is overstated by R1 032 464;
 - Revenue service charges as disclosed in note 22 to the financial statements is understated by R582 385;
 - Unspent conditional grant as disclosed in note 14 to the statements is understated by R484 872.

Adverse opinion

25. In my opinion, because of the significance of the matters described in the basis for adverse opinion paragraphs, these financial statements do not present fairly the financial position of the Gariep Local Municipality as at 30 June 2013 and its financial performance and cash flows for the year then ended, in accordance with South African Generally Recognised Accounting Policies and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No.5 of 2012) (DoRA).

Emphasis of matters

26. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Significant uncertainties

27. The municipality may be liable for a penalty of R10 million for not obtaining a license for five landfill sites which are in use as disclosed in note 36.

Restatement of corresponding figures

28. As disclosed in note 37 and 38 to the financial statements, the corresponding figures have been restated as a result of errors only corrected during the year ended 30 June 2013 that existed in the financial statements at, and for the year ended, 30 June 2012.

Financial sustainability

29. While the municipality has prepared financial statements on a going concern basis there are a number of indicators that its financial sustainability is under threat. These include the following:

- Revenue is being under collected,
- Loans are not being paid timeously,
- Creditors are not being paid within 30 days,
- Medical and pension fund contributions are not timeously paid over to the respective funds.

Material losses

30. As disclosed in note 45 to the financial statements the municipality incurred losses on the distribution of electricity amounting to R5 400 000 during the year under review.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

31. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

32. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.
33. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned objectives/ development priorities. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the *National Treasury Framework for managing programme performance information*.

The reliability of the information in respect of the selected programmes is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

Usefulness of Information

Presentation

34. Section 46 of the Municipal Systems Act requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved and measures taken to improve performance were not always reported in the annual performance report for instances where indicators and/or targets were not achieved.

Consistency

Reported objectives not consistent with planned objectives, indicators and targets

35. Municipal Systems Act, section 41(c) requires that the integrated development plan should form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 64% of the reported objectives are not consistent with the objectives as per the approved integrated development plan. This is due to the lack of audit evidence available to substantiate changes approved by council.

Reported indicators and targets not consistent with planned objectives, indicators and targets

36. Municipal Systems Act, section 41(c) requires that the integrated development plan should form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 100% of the reported indicators and targets are not consistent with the indicators and targets as per the approved integrated development plan. This is due to the lack of audit evidence available to substantiate changes approved by council.

Measurability

Performance indicators are not well-defined

37. The National Treasury *Framework for managing programme performance information (FMPPi)* requires that indicators should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 29% of the indicators and significantly important indicators in relation to the overall mandate of the municipality were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the fact management was aware of the requirements of the *FMPPi* but did not receive the necessary training to enable application of the principles.

Performance indicators are not verifiable

38. The National Treasury *Framework for managing programme performance information (FMPPi)* requires that it must be possible to validate the processes and systems that produce the indicator. A total of 89% of the indicators and significantly important indicators in relation to the overall mandate of the municipality were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the lack of key controls in the relevant systems of collection/collation/ verification/ storage of actual performance information.

Reliability of information

Programme: Revenue management

39. The National Treasury *Framework for managing programme performance information (FMPPi)* requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets.
40. Significantly important targets with respect to Revenue management are
- materially misstated
 - not reliable when compared to the source information and evidence provided.

41. This was due to the lack of frequent review of validity of reported achievements against source documentation

Programme: Budget and reporting

42. The National Treasury *Framework for managing programme performance information (FMPPi)* requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets.
43. Significantly important targets with respect to Budget and reporting are
- materially misstated,
 - not reliable when compared to the source information and evidence provided.
44. This was due to the lack of frequent review of validity of reported achievements against source documentation.

Additional matters

45. I draw attention to the following matters below. These matters do not have an impact on the predetermined objectives audit findings reported above.

Achievement of planned targets

46. Of the total number of 98 targets planned for the year, 34 of targets were not achieved during the year under review. This represents 34% of total planned targets that were not achieved during the year under review.
47. This was mainly due to the fact that indicators and targets were not suitably developed during the strategic planning process

Material adjustments to the annual performance report

48. Material audit adjustments in the annual performance report were identified during the audit, of which 44% were corrected by management and those that were not corrected are included in the basis for qualified conclusion paragraphs.

Compliance with laws and regulations

49. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *General Notice* issued in terms of the PAA are as follows:

Strategic planning and performance management

50. The municipality did not set key performance indicators, including input indicators, output indicators and outcome indicators, in respect of each of the development priorities and objectives set out in the Integrated development plan, as required by section 41(1)(a) of the Municipal Systems Act and the Municipal planning and performance management regulation 1 and 9(1)(a).
51. The performance management system of the municipality did not clarify the roles and responsibilities of each role-player in the functioning of the system as required by section 38(a) of the Municipal Systems Act and/or Municipal planning and performance management regulation 7(2)(c).
52. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the Municipal Systems Act.
53. The audit committee did not make recommendations to the council as required by Municipal planning and performance management regulation 14(4)(a)(ii).

54. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal planning and performance management regulation 14(4)(a)(iii).
55. The annual performance report for the year under review does not include a comparison with the previous financial year measures taken to improve performance as required by section 46 (1(a) of the Municipal Systems Act.

Budget

56. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the Municipal Finance Management Act.

Annual Financial Statements and Annual Report

57. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the Municipal Finance Management Act. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving an adverse audit opinion.
58. The council's oversight report on the 2012/13 annual report was not made public within seven days of its adoption, as required by section 129(3) of the Municipal Finance Management Act.
59. Sufficient appropriate audit evidence could not be obtained to verify that oversight report, containing comments on the annual report, was adopted by council within two months from the date on which the 2011/12 annual report was tabled, as required by section 129(1) of the Municipal Finance Management Act.

Procurement and Contract Management

60. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a).
61. Contracts were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act.
62. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
63. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.

Human Resource Management and compensation

64. Sufficient appropriate audit evidence could not be obtained that the municipal manager and senior managers directly accountable to the municipal manager did sign the performance agreements, as required by section 57(2)(a) Municipal Systems Act.
65. An acting senior manager was appointed for a period of more than six months, in contravention of section 54A (2A) of the Municipal Systems Act.

Expenditure Management

66. Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the Municipal Finance Management Act

67. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred and accounted for creditors, as required by section 65(2)(b) of the Municipal Finance Management Act.
68. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the Municipal Finance Management Act.

Liability Management

69. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the Municipal Finance Management Act.
70. Unspent conditional grant funds not approved by the National Treasury for retention, were not surrendered to National Revenue Fund, as required by section 21(1) of the Division of Revenue Act.

Consequences Management

71. The condoning of irregular expenditure was not approved by the appropriate relevant authority, in accordance with the requirements of sections 1 and 170 of the Municipal Finance Management Act.

Asset Management

72. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the Municipal Finance Management Act.
73. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the Municipal Finance Management Act.
74. All investments were not made in the name of the municipality, as required by Municipal investment regulation 12(2).

Internal control

75. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for adverse opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

76. The accounting authority did not adequately review the financial statements and the annual performance report prior to their submission for audit which resulted in the material misstatements being identified.
77. The municipality did not have adequate documented policies and procedures to guide the operations of the municipality, resulting in numerous instances of non-compliance with the MFMA. In addition to this municipality did not have documented and approved internal policies and procedures to address the process of collection, recording, processing, monitoring and reporting of performance information.

Financial and performance management

78. Management did not implement daily and monthly controls as designed by the municipalities business processes, resulting in significant misstatements identified during the audit.

79. Compliance with the applicable laws and regulations is not monitored on a regular basis⁴⁰ which resulted in material non-compliance findings.

Governance

80. Although internal audit and audit committee meet regularly throughout the year, they were not effective in strengthening the control environment within the municipality as numerous material misstatements, as well as material findings on performance reporting and compliance matters were identified during the audit process.

OTHER REPORTS

Investigations

81. An investigation is being conducted for the unauthorised instruction to transfer amounts out of the municipality's investment account.



Auditor-General

East London

30 November 2013



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence